We market our products and related services to customers in four geographic regions: North America, Europe (Europe, the Middle East and Africa), Japan, and Asia-Pacific. Internationally, we market our products and services primarily through our subsidiaries and various distributors. Revenue is attributed to geographic areas based on the country in which the customer is domiciled. The table below sets forth geographic distribution of revenue data for the three and six months ended October 2, 2005 and September 30, 2004 (in thousands, except percentage data):

	October 2, 2005	% of Revenue	September 30, 2004	% of Revenue	Dollar Change	% Change
Three Months Ended:						
Domestic	$ 29,344	74%	$ 20,137	55%	$ 9,207	46%
International:						
Europe	4,495	11%	5,415	15%	(920)	(17)%
Japan	3,739	9%	9,705	26%	(5,966)	(61)%
Asia-Pacific (excluding Japan)	2,308	6%	1,671	4%	637	38%
Total International	10,542	26%	16,791	45%	(6,249)	(37)%
Total revenue	$ 39,886	100%	$ 36,928	100%	$ 2,958	8%
Six Months Ended:						
Domestic	$ 57,505	73%	$ 43,115	59%	$ 14,390	33%
International:						
Europe	8,696	11%	10,265	14%	(1,569)	(15)%
Japan	7,975	10%	15,271	21%	(7,296)	(48)%
Asia-Pacific (excluding Japan)	4,542	6%	4,306	6%	236	6%
Total International	21,213	27%	29,842	41%	(8,629)	(29)%
Total revenue	$ 78,718	100%	$ 72,957	100%	$ 5,761	8%

Revenue

- **Revenue** for the three and six months ended October 2, 2005 was $39.9 million and $78.7 million, respectively, both up 8% from the comparable periods in the prior year.
- **License revenue** increased in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year primarily due to large orders executed during fiscal 2006 in North America. These orders came from existing customers who extended license periods and added license capacity due to the continued proliferation of existing and new Magma products, amongst their design group designers. The increase in domestic revenue was partially offset by a decrease in revenue from Japan for both the three and six months ended October 2, 2005 compared to the comparable periods in fiscal 2005. Two customers each accounted for greater than 10% of the revenue for the quarter ended October 2, 2005 and one customer accounted for greater than 10% of the revenue for the six months ended October 2, 2005. License revenue as a percentage of revenue was lower in the second quarter of fiscal 2006 as compared to the second quarter in fiscal 2005 due to higher services and retro maintenance revenue, and was fairly consistent in the six months ended October 2, 2005 as compared to the comparable period in fiscal 2005.
- **Service revenue** increased in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year primarily due to a $1.2 million and $1.7 million, respectively, increase in maintenance revenue, and a $0.8 million and $62,000, respectively, increase in revenue from consulting service. The increase in maintenance revenue was primarily due to our large customers accelerating their deployment of our licenses and placing additional service orders.

- **Domestic revenue** increased in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year primarily due to a one time, non recurring payment for the termination of an existing customer's license agreement. The payment arose from sale of this customer's semiconductor division to a third party. The third party, also an existing Magma customer, purchased additional software licenses for use by engineers transferred in the acquisition. For the six months ended October 2, 2005, domestic revenue increased compared to the comparable period in the prior year also due to a single customer in North America purchasing additional capacity of existing licenses and licenses to new technology products. Domestic revenue as a percentage of total revenue increased by 19% and 14%, respectively, in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year.
- **International revenue** decreased in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year primarily due to our existing customers in Japan and Europe demanding less capacity of existing licenses and licenses to new technology products.

Cost of Revenue

- **Cost of license revenue** primarily consists of amortization of acquired developed technology and other intangible assets, software maintenance costs, royalties and allocated outside sale representative expenses. Cost of license revenue increased by $4.8 million and $7.9 million, respectively, in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year primarily due to an increase of $4.0 million and $6.0 million, respectively, amortization relating to certain licensed technologies, as the Company began recognizing revenue from products based on these licensed technologies during the first and second quarter of fiscal 2006. The amortization expense on these technologies was included in operating expense in prior year periods. The remainder of the increase in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year was due to amortization on new intangibles, such as earnouts related to previous acquisitions.
- **Cost of service revenue** primarily consists of personnel and related costs to provide product support, consulting services and training. Cost of service revenue also includes asset depreciation, allocated outside sale representative expenses and amortization of deferred stock-based compensation. Cost of service revenue increased by $0.7 million and $0.8 million, respectively, in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year primarily due to an increase of personnel and related costs for application engineers that corresponded to higher consulting and maintenance activities in the fiscal 2006 periods.

Operating expenses

The table below sets forth operating expense data for the three and six months ended October 2, 2005 and September 30, 2004 (in thousands, except percentage data):

	October 2, 2005	% of Revenue	September 30, 2004	% of Revenue	Dollar Change	% Change
Three Months Ended:						
Operating expenses:						
Research and development	$ 11,381	29%	$ 10,524	28%	$ 857	8%
In-process research and development	—	—%	—	—%	—	—%
Sales and marketing	10,658	27%	11,679	32%	(1,021)	(9)%
General and administrative	9,842	25%	3,455	9%	6,387	185%
Amortization of intangible assets	2,882	7%	4,093	11%	(1,211)	(30)%
Amortization of stock-based compensation	1,273	3%	116	—%	1,157	997%
Restructuring costs	—	—%	(63)	—%	63	100%
Total operating expenses	$ 36,036	90%	$ 29,804	81%	$ 6,232	21%

	October 2, 2005	% of Revenue	September 30, 2004	% of Revenue	Dollar Change	% Change
Six Months Ended:						
Operating expenses:						
Research and development	$ 22,356	28%	$ 20,093	28%	$ 2,263	11%
In-process research and development	—	—%	4,009	5%	(4,009)	(100)%
Sales and marketing	21,860	28%	22,946	31%	(1,086)	(5)%
General and administrative	18,455	23%	7,080	10%	11,375	161%
Amortization of intangible assets	6,470	8%	8,568	12%	(2,098)	(24)%
Amortization of stock-based compensation	2,945	4%	574	1%	2,371	413%
Restructuring costs	—	—%	439	1%	(439)	100%
Total operating expenses	$ 72,086	92%	$ 63,709	87%	$ 8,377	13%

- **Research and development expense** increased in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year primarily due to an increase in payroll related expenses of $1.6 million and $3.0 million, respectively, which included an increase in bonus expense of $1.5 million and $2.0 million, respectively, and an increase in salaries and related expenses of $0.1 million and $0.9 million, respectively, due to the increase of senior and experienced staff in research and development through direct hiring and business acquisitions. For the six months ended October 2, 2005, the increase in research and development expense was also caused by higher allocated common expenses (e.g., facility related expenses) of $0.4 million compared to the same period in the prior year. The increases in research and development expense in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year were partially offset by a decrease in software maintenance costs of $0.6 million and $1.2 million, respectively, due to the fact that a major software maintenance contract expired in the last quarter of fiscal 2005. The remainder of the fluctuation in research and development expense was accounted for by other individually insignificant items. We expect our quarterly research and development expense in each of the remaining two quarters of fiscal 2006 to increase moderately compared with the amount in the first and second quarter of fiscal 2006 as our research and development headcount will increase driving up both fixed and variable compensation levels.
- **In-process research and development ("IPR&D")** expense of $4.0 million for the six months ended September 30, 2004 consisted of a charge recorded in connection with our acquisition of Mojave, Inc. in April 2004. The charge was recorded based on management's final purchase price allocation. There has been no material change to the IPR&D project schedule as of October 2, 2005. Revenue resulting from the IPR&D project commenced around the end of the first quarter of fiscal 2006.
- **Sales and marketing expense** decreased in the three months ended October 2, 2005 compared to the comparable period in the prior year primarily due to a decrease in commission expense of $0.7 million, an increase in expenses allocated to cost of service revenue (primarily application engineering costs) of $0.7 million and a decrease in marketing communications of $0.3 million. Sales and marketing expense decreased in the six months ended October 2, 2005 compared to the comparable period in the prior year primarily due to a decrease in commission expense of $0.7 million, an increase in expenses allocated to cost of service revenue (primarily application engineering costs) of $0.3 million, a decrease in travel and entertainment expense of $0.4 million, and a decrease in professional services of $0.2 million. The decreases in sales and marketing in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year were partially offset by an increase in payroll related expenses of $0.5 million and $0.6 million, respectively, which consisted of an increase in bonus expense of $1.3 million and $1.1 million, respectively, partially offset by a decrease in salaries and related expenses of $0.7 million and $0.5 million, respectively, due to the transfer of certain application engineers to research and development. We expect our quarterly sales and marketing expenses in each of the remaining two quarters of fiscal 2006 to increase moderately compared with the amount in the first and second quarter of fiscal 2006 primarily as a function of increased variable compensation costs driven by bookings and revenue growth.

- **General and administrative expense** increased in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year primarily due to increases in professional service fees of $5.2 million and $9.2 million, respectively, payroll related expenses of $0.9 million and $1.5 million, respectively, and asset depreciation of $0.6 million and $1.3 million, respectively, partially offset by an increase in allocated cost to other functional areas of $0.1 million and $0.8 million, respectively, due to higher common expenses in the first and second quarters of fiscal 2006 compared to the same periods in the prior year. The increase in professional service fees in the three and six months ended October 2, 2005 primarily consisted of legal expenses, which were accrued for as incurred, related to patent litigation with Synopsys, Inc. and other law suits. The remainder of the fluctuation in general and administrative expense was accounted for by other individually insignificant items. We expect that our quarterly general and administrative expense in each of the remaining two quarters of fiscal 2006 will be consistent with the amount in the first and second quarter of fiscal 2006 as our general and administrative head count growth will be moderate, legal expenses and professional services related to litigation will increase slightly and variable compensation will grow moderately driven by increased revenue.
- **Restructuring costs** in the fiscal 2005 periods consisted of employee termination charges resulting from the Company's realignment to current business conditions in the first quarter of fiscal 2005.
- **Amortization of intangible assets** decreased in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year primarily due to the change in classification, from operating expenses to cost of license revenue, of a $4.0 million and $6.0 million, respectively, amortization relating to certain developed technologies . The Company began recognizing revenues from products based on these developed technologies during the first and second quarter of fiscal 2006. The decrease was partially offset by amortization of new intangible assets acquired subsequent to the first and second quarter of fiscal 2005. The intangible assets being amortized include technology licenses, trademarks, customer contracts, customer relationships, no shop rights and non-competition agreements that were identified in the purchase price allocation for each business combination and asset purchase transaction.
- **Amortization of deferred stock-based compensation** increased in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year primarily due to an increase in amortization of deferred stock-based compensation of $0.8 million and $1.6 million, respectively, related to deferred stock compensation recorded in connection with the Company's 2005 Key Contributor Incentive Plan, and also due to a stock-based compensation expense of $0.2 million related to the option exchange in August 2005. For the six months ended October 2, 2005, the increase was also due to an increase in amortization of deferred stock-based compensation of $0.6 million and $0.2 million related to the acquisitions of Mojave and VeraTest, respectively. The increases in the three and six months ended October 2, 2005 were partially offset by a decrease in amortization of deferred stock-based compensation of $0.1 million and $0.3 million, respectively, related to deferred stock compensation recorded in connection with our IPO in November 2001.

  During the second quarter of 2005, we offered a voluntary stock option exchange program to our employees which resulted in variable accounting treatment for, at the time of the exchange, options to purchase an aggregate of approximately 5.5 million shares of its common stock. We are accounting for all replacement stock options, as well as all options that were subject to the exchange program but were retained by employees, using variable accounting until adoption of SFAS 123R. Under variable accounting, cumulative stock compensation expense at any balance sheet date must equal accumulated amortization of the current intrinsic value of the outstanding variable stock awards over their vesting periods. Upon adoption of SFAS 123R, in accordance with its rules, the amount of stock compensation expense will be fixed based on initial estimated fair values of the replacement stock options and amortized over the remaining vesting periods of these options. Stock compensation expense recognized until adoption of SFAS 123R using variable accounting will not be reversed upon adoption. Variable accounting treatment may result in unpredictable and potentially significant charges or credits recorded to stock-based compensation, which will be dependent upon fluctuations in the quoted market prices of our common stock.

Other items

The table below sets forth other data for the three and six months ended October 2, 2005 and September 30, 2004 (in thousands, except percentage data):

	October 2, 2005	% of Revenue	September 30, 2004	% of Revenue	Dollar Change	% Change
Three Months Ended:						
Other income (expense), net:						
Interest income	$ 586	1%	$ 556	2%	$ 30	5%
Interest expense	(224)	(1)%	(251)	(1)%	27	(11)%
Other expense, net	(352)	(1)%	(642)	(2)%	290	(45)%
Total other income (expense), net	$ 10	—%	$ (337)	(1)%	$ 347	
Benefit from (provision for) income taxes	$ 528	1%	$ (990)	(3)%	$ (1,518)	
Six Months Ended:						
Other income (expense), net:						
Interest income	$ 1,246	2%	$ 1,109	2%	$ 137	12%
Interest expense	(432)	(1)%	(497)	(1)%	65	(13)%
Other income (expense), net	7,098	9%	(1,204)	(2)%	8,302	(690)%
Total other income (expense), net	$ 7,912	10%	$ (592)	(1)%	$ 8,504	
Provision for income taxes	$ (1,908)	(2)%	$ (352)	—%	$ (1,556)	

- **Interest income** increased in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year primarily due to higher interest rate on our cash and investments balance during the fiscal 2006 periods. Even though our total cash and investment balance was lower in fiscal 2006 periods, the combination of higher short-term interest rates, together with the liquidation of long-term instruments during fiscal 2006 which were purchased at much lower rates and the subsequent reinvestment of maturing funds into higher short-term yielding instruments produced higher interest income in the three and six months ended October 2, 2005 compared to the comparable periods in fiscal 2005.
- **Interest expense** primarily represents amortization of debt discount and issuance costs, which were recorded in connection with our convertible subordinated debt offering completed in May 2003. In May 2005, we repurchased approximately 29.7% of the convertible subordinated debt. In connection with the repurchase, we wrote off $0.9 million of the unamortized debt issuance costs related to the repurchased portion of the convertible subordinated debt. As a result, amortization of debt issuance costs decreased by $73,000 and $119,000, respectively, in the three and six months ended October 2, 2005 compared to the comparable periods in the prior year. The decrease was partially offset by increase of interest expense on capital leases in fiscal 2006 periods.
- **Other income (expense), net** in the three and six months ended October 2, 2005 consisted of a charge of $0.1 million and $0.5 million, respectively, associated with other than temporary impairment in our strategic investments and a foreign exchange loss of $0.2 million and $0.5 million, respectively. Other income, net in the six months ended October 2, 2005 also included a $9.7 million gain on repurchase of $44.5 million of the convertible subordinated debt, partially offset by a $0.9 million write-off of the debt issuance costs related to the repurchase and a $0.7 million of loss on sale of short-term investments. Other expense, net in the three and six months ended September 30, 2004 consisted of a charge of $0.3 million and $0.7 million, respectively, associated with other than temporary impairment in our strategic

investments and $0.3 million and $0.5 million, respectively, of foreign exchange loss. The impairment charge was determined based on our periodic review of the investee company's financial performance, financial conditions and near-term prospects. The slight increase of foreign exchange loss in the fiscal 2006 periods was caused by an unfavorable exchange rate fluctuation between the U.S. Dollar and the Japanese Yen.

- **Benefit from (provision for) income taxes.** The income tax provided for the three months ended October 2, 2005 is a benefit of $528,000, compared to an expense of $1.0 million for the three months ended September 30, 2004. The tax benefit of $528,000 consists primarily of the adjustment to the federal and state taxes provided in the prior quarter for certain discrete items, such as gain on the partial retirement of the convertible bond, impairment of certain equity investments and loss on disposal of certain investments due to the change in Company's forecasts, as well as the federal, state and foreign taxes provided for the income derived from our normal operations. The income tax provisions are $1.9 million and $352,000 for the six months ended October 5, 2005 and September 30, 2004, respectively. Our effective tax rates vary from the U.S. statutory rate primarily due to changes in our valuation allowance, state taxes, foreign income at other than U.S. rates, deferred compensation, in-process research and development, research and development credits, and foreign withholding taxes.

  We are in a net deferred tax asset position, for which a full valuation allowance has been recorded. We will continue to provide a valuation allowance on our net deferred tax assets until it becomes more likely than not that the deferred tax assets will be realizable. The Company will continue to evaluate the realizability of the deferred tax assets on a quarterly basis.

  In the event of a future change in ownership, as defined under federal and state tax laws, our net operating loss and tax credit carryfowards may be subject to an annual limitation. The annual limitations may result in an increase to our current income tax provision and/or the expiration of the net operating loss and tax credit carryforwards before realization.

Liquidity and Capital Resources

(Dollar in Thousands)	October 2, 2005	March 31, 2005
Cash, cash equivalents and short-term investments	$ 88,471	$ 135,518

	Six Months Ended	
	October 2, 2005	September 30, 2004
Net cash provided by operating activities	$ 23,426	$ 18,900
Net cash provided by (used in) investing activities	$ 56,872	$ (3,066)
Net cash used in financing activities	$ (47,375)	$ (11,143)

During the fourth quarter of fiscal 2005, we reclassified auction rate securities of $31.5 million and $55.1 million as of September 30, 2004 and March 31, 2004, respectively, from cash and cash equivalents to short-term investments. We have reclassified the purchases and sales of these auction rate securities in our condensed consolidated statements of cash flows, which decreased our cash used in investing activities by $23.6 million for the six months ended September 30, 2004.

Our cash, cash equivalents and short-term investments, excluding restricted cash, were approximately $88.5 million at October 2, 2005, a decrease of $47.0 million or 35% from March 31, 2005. The decrease primarily reflected cash generated from operations and proceeds from common stock issuances, which in fiscal 2006 were more than offset by cash used for repurchase of a portion of the convertible subordinated notes, repurchase of common stock, purchases of intangible assets, equity investments and capital investments. Our investment portfolio consists of high-grade fixed-income securities diversified among corporate, US agency and municipal issuers with maturities of two years or less. A portion of the portfolio is allocated to auction rate securities which provide liquidity at par every 28 days with underlying longer-term maturities.

On April 13, 2005, we announced that our Board of Directors authorized Magma to repurchase up to 2.0 million shares of our common stock. The stock repurchase program was completed in May 2005. We used approximately $16.0 million to repurchase 2.0 million shares of common stock. The repurchased shares are to be used for general corporate purposes.

In early May 2005, we repurchased, in privately negotiated transactions, $44.5 million face amount (or approximately 29.7 percent of the total) of these notes at an average discount to face value of approximately 22 percent. We spent an aggregate of approximately $34.8 million on the repurchase. The repurchase leaves approximately $105.5 million aggregate principal amount of convertible subordinated notes outstanding. At the same time we terminated a portion (approximately 29.7 percent) of the hedging arrangements.

Net cash provided by operating activities

Net cash provided by operating activities was $23.4 million in the six months ended October 2, 2005 compared to $18.9 million in the comparable period in the prior year. The $4.5 million increase was primarily due to a $9.3 million increase in cash from customers, a $9.7 million decrease in payments associated with accounts payable and accrued liabilities and a $1.0 million increase in cash from interest income. These increases in cash flow were partially offset by a $13.6 million increase in costs and expenses, and a $1.9 million increase in payments associated with prepaid and other assets balances. The increase in cash from customers was primarily due to higher cash collection on accounts receivable during the six months ended October 2, 2005 compared to the comparable period in fiscal 2005. The payment of accrued liabilities during the six months ended September 30, 2004 was primarily related to a payout of accrued bonuses during the period. The increase in payments associated with prepaid expenses during the six months ended October 2, 2005 was primarily caused by an increase of $1.5 million payment on prepaid software maintenance expense.

Net cash provided by (used in) investing activities

Net cash provided by investing activities was $56.9 million in the six months ended October 2, 2005. We had net proceeds of $80.1 million from sales of marketable securities as we liquidated these investments to repurchase a portion of the convertible subordinated notes. Partially offsetting the cash inflow, we used a total of $20.4 million in cash to purchase a technology license and make earnout payments relating to prior asset purchases. We also made an investment of $0.8 million in a privately held technology company for business and strategic purposes. We may make additional strategic equity investments in the future by using our cash, cash equivalents and/or investments. In addition, we acquired property and equipment totaling $2.0 million in cash and $2.0 million through capital leases. We expect to make capital expenditures of approximately $5.2 million for the remainder of fiscal 2006. These capital expenditures will be used to support selling, marketing and product development activities. We will use capital lease financing as well as our cash and cash equivalents and/or investments to fund these purchases.

Net cash used in investing activities was $3.1 million in the six months ended September 30, 2004. We used cash to complete the Mojave and Lemmatis asset purchase transactions during the six months ended September 30, 2004 in order to broaden our product offerings and to incorporate certain key technologies into our existing products and paid a total of $9.1 million in cash, net of cash acquired. We also made investments of $1.1 million in two privately held technology companies for business and strategic purposes. In August 2004, we made a total of $2.8 million milestone payment relating to prior asset purchases. During the six months ended September 30, 2004, we acquired property and equipment totaling $9.2 million. The property and equipment expenditures were primarily for purchases of computer equipment and research and development tools to support our growing operations. The primary source of cash from investing activities was net proceeds of $19.1 million from maturities of short-term investments.

Net cash used in financing activities

Net cash used in financing activities was $47.4 million in the six months ended October 2, 2005. We used $34.8 million to repurchase a portion of our convertible subordinated notes and received net proceeds of

$140,000 from termination of the related portion of the bond hedge and warrant. In addition, we used $16.0 million to repurchase 2,000,000 shares of common stock on the open market, as authorized by the board of directors in April 2005, and made payments of $0.3 million on our capital leases. The primary source of cash was $3.6 million in cash received from the exercise of stock options and shares purchased under the employee stock purchase plan during the period.

Net cash used in financing activities was $11.1 million in the six months ended September 30, 2004. The primary source of cash was $5.5 million of cash received from the exercise of stock options and the purchase of shares under the employee stock purchase plan. We used $16.6 million to repurchase 1,000,000 shares of common stock on the open market, as authorized by the board of directors in July 2004.

Capital resources

We believe that our existing cash and cash equivalents and short-term investments will be sufficient to meet our anticipated operating and working capital expenditure requirements in the ordinary course of business for at least the next 12 months. If we require additional capital resources to grow our business internally or to acquire complementary technologies and businesses at any time in the future, we may use cash or need to sell additional equity or debt securities. The sale of additional equity or convertible debt securities may result in more dilution to our existing stockholders. Financing arrangements may not be available to us, or may not be available in amounts or on terms acceptable to us.

Our acquisition agreements related to certain business combination and asset purchase transactions obligate us to pay certain contingent cash and stock considerations based on meeting certain booking or project milestones and continued employment. Total amount of cash and stock contingent considerations that could be paid or issued under our acquisition agreements assuming all contingencies are met is $46.6 million and $45.6 million, respectively, as of October 2, 2005. The number of contingent shares to be issued is dependent on the market price of our common stock near when the milestones are achieved.

Contractual obligations

As of October 2, 2005, our principal commitments consisted of operating leases, with an aggregated future amount of $12.1 million through fiscal 2011 for office facilities, and repayment of the convertible subordinated notes of $105.5 million due in fiscal 2009. During the six months ended October 2, 2005, other than the decrease of $44.5 million in the convertible subordinated notes, there were no material changes in our reported payments due under contractual obligations at March 31, 2005. Although we have no material commitments for capital expenditures, we anticipate a substantial increase in our capital expenditures and lease commitments with our anticipated growth in operations, infrastructure, and personnel. In addition, we have other obligations for goods and services entered into in the normal course of business. These obligations, however, either are not enforceable or legally binding or are subject to change based on our business decisions.

Off-balance Sheet Arrangements

As of October 2, 2005, we did not have any significant "off-balance sheet arrangements," as defined in Item 303(a)(4)(ii) of Regulation S-K.

Indemnification Obligations

We enter into standard license agreements in the ordinary course of business. Pursuant to these agreements, we agree to indemnify our customers for losses suffered or incurred by them as a result of any patent, copyright, or other intellectual property infringement claim by any third party with respect to our products. These indemnification obligations have perpetual terms. Our normal business practice is to limit the maximum amount of indemnification to the amount received from the customer. On occasion, the maximum amount of indemnification we may be required to make may exceed its normal business practices. We estimate the fair

value of its indemnification obligations as insignificant, based on our historical experience concerning product and patent infringement claims. Accordingly, we had no liabilities recorded for indemnification under these agreements as of October 2, 2005.

We have agreements whereby our officers and directors are indemnified for certain events or occurrences while the officer or director is, or was, serving at our request in such capacity. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have a directors and officers insurance policy that reduces our exposure under these agreements. As a result of our insurance policy coverage, we believe the estimated fair value of these indemnification agreements is minimal. Accordingly, no liabilities have been recorded for these agreements as of October 2, 2005.

In connection with recent business acquisitions, we agreed to assume, or cause our subsidiaries to assume, indemnification obligations to the officers and directors of acquired companies.

Warranties

We offer our customers a warranty that our products will conform to the documentation provided with the products. To date, there have been no payments or material costs incurred related to fulfilling these warranty obligations. Accordingly, we have no liabilities recorded for these warranties as of October 2, 2005. We assess the need for a warranty accrual on a quarterly basis, and there can be no guarantee that a warranty accrual will not become necessary in the future.

FACTORS THAT MAY AFFECT OUR BUSINESS AND FUTURE RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Our business faces many risks. The risks described below may not be the only risks we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the events or circumstances described in the following risks actually occur, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline.

Our limited operating history makes it difficult to evaluate our business and prospects.

We were incorporated in April 1997 and introduced our first principal software product, Blast Fusion, in April 1999. We have a limited history of generating revenue from our software products, and the revenue and income potential of our business and market is still unproven. As a result of our short operating history, we have limited financial data that can be used to evaluate our business. We have only been profitable for eight of the last thirteen fiscal quarters, and we were not profitable prior to fiscal 2003. Our software products represent a new approach to the challenges presented in the electronic design automation market, which to date has been dominated by established companies with longer operating histories. Key markets within the electronic design automation industry may fail to adopt our proprietary technologies and software products. Any evaluation of our business and our prospects must be considered in light of our limited operating history and the risks and uncertainties often encountered by relatively young companies.

We have a history of losses, except for fiscal 2003 and fiscal 2004, and have an accumulated deficit of approximately \$122.3 million as of October 2, 2005; if we do not increase profitability, the public trading price of our stock would be likely to decline.

We had an accumulated deficit of approximately \$122.3 million as of October 2, 2005. Although we achieved profitability in fiscal 2003 and fiscal 2004, we incurred losses in other fiscal years and the first and second quarter of fiscal 2006. If we continue to incur losses, or if we fail to achieve profitability at levels expected by securities analysts or investors, the market price of our common stock is likely to decline. If we incur net losses, we may not be able to maintain or increase our number of employees or our investment in capital equipment, sales, marketing, and research and development programs, and we may not be able to continue to operate.

Our quarterly results are difficult to predict, and if we miss quarterly financial expectations, our stock price could decline.

Our quarterly revenue and operating results fluctuate from quarter to quarter and are difficult to predict. It is likely that our operating results in some periods will be below investor expectations. If this happens, the market price of our common stock is likely to decline. Fluctuations in our future quarterly operating results may be caused by many factors, including:

- size and timing of customer orders, which are received unevenly and unpredictably throughout a fiscal year;
- the mix of products licensed and types of license agreements;
- our ability to recognize revenue in a given quarter;
- higher than anticipated costs in connection with patent litigation with Synopsys, Inc.;
- timing of customer license payments;
- the relative mix of time-based licenses bundled with maintenance, unbundled time-based license agreements and perpetual license agreements, each of which has different revenue recognition practices;
- size and timing of revenue recognized in advance of actual customer billings and customers with graduated payment schedules which may result in higher accounts receivable balances and days sales outstanding ("DSO");
- the relative mix of our license and services revenue;
- our ability to win new customers and retain existing customers;
- changes in our pricing and discounting practices and licensing terms and those of our competitors;
- changes in the level of our operating expenses, including increases in incentive compensation payments that may be associated with future revenue growth;
- variability in stock-based compensation charges related to our option exchange program;
- changes in the interpretation of the authoritative literature under which we recognize revenue;
- the timing of product releases or upgrades by us or our competitors; and
- the integration, by us or our competitors, of newly-developed or acquired products.

We currently face lawsuits brought by Synopsys, Inc. related to patent infringement, and we may face additional intellectual property infringement claims or other litigation. Lawsuits can be costly to defend, can take the time of our management and employees away from day-to-day operations, and could result in our losing important rights and paying significant damages.

On September 17, 2004, Synopsys, Inc., filed suit against us for patent infringement, and it subsequently filed patent related litigation in Germany and Japan (please see the discussion in Part II. Item 1.—"Legal Proceedings" below for further detail). Other related litigation may follow. In the future other parties may assert intellectual property infringement claims against us or our customers. We may have acquired or may in the future acquire software as a result of our acquisitions, and we could be subject to claims that such software infringes the intellectual property rights of third parties. In addition, we are often involved in or threatened with commercial litigation unrelated to intellectual property infringement claims such as labor litigation and contract claims, and we may acquire companies that are actively engaged in such litigation.

Our products may be found to infringe intellectual property rights of third parties, including third-party patents. In addition, many of our contracts contain provisions in which we agree to indemnify our customers from third-party intellectual property infringement claims that are brought against them based on their use of our

products. Also, we may be unaware of filed patent applications that relate to our software products. We believe the patent portfolios of our competitors are far larger than ours, and this may increase the risk that they may sue us for patent infringement and may limit our ability to counterclaim for patent infringement or settle through patent cross-licenses.

The outcome of intellectual property litigation, such as the pending Synopsys litigation (discussed herein), could be our loss of critical proprietary rights and unexpected operating costs. Intellectual property litigation is expensive and time-consuming and could divert management's attention from our business. If there is a successful claim of infringement, we may be ordered to pay substantial monetary damages (including punitive damages), we may be prevented from distributing all or some of our products, and we may be required to develop non-infringing technology or enter into royalty or license agreements, which may not be available on acceptable terms, if at all. Our failure to develop non-infringing technologies or license the proprietary rights on a timely basis would harm our business.

In June, 2005, a putative shareholder class action lawsuit was filed against us in federal court as further identified in Part II, Item 1.—"Legal Proceedings." Generally, the complaint in this lawsuit alleges that we and some of our executive officers failed to disclose information about the risk of Magma infringing intellectual property rights of Synopsys, Inc..

In July, 2005, a putative derivative lawsuit was filed against us in state court as further identified in Part II, Item 1.—"Legal Proceedings." The complaint in this lawsuit seeks unspecified damages purportedly on behalf of the Company for alleged breaches of fiduciary duties by various directors and officers, as well as for alleged violations of insider trading laws by executives.

On September 26, 2005, Synopsys, Inc. filed an action against the Company in the Superior Court of the State of California alleging that Magma committed unfair business practices by asserting defenses of non-infringement and invalidity to patent infringement allegations brought by Synopsys in the September 17, 2004 patent infringement action. On the Company's motion, the action was removed to the United States District Court and related to the September 17, 2004 action. (See also Item II, Part I—"Legal Proceedings")

On September 26, 2005, Synopsys, Inc. filed an action against the Company in Delaware federal court, alleging infringement of U.S. Patent Nos. 6,434,733 ("the '733 Patent"), 6,766,501 ("the '501 Patent"), and 6,192,508 ("the '508 Patent") and seeks unspecified monetary damages, injunctive relief, trebling of damages, fees and costs, and the imposition of a constructive trust for the benefit of Synopsys over benefits allegedly obtained by the Company as a result of its alleged infringement. On October 19, 2005, the Company filed its answer and counterclaims to Synopsys' Complaint. On October 25, 2005, the Company filed an Amended Answer, adding a counterclaim for infringement of U.S. Patent No. 6,505,328 ("the '328 Patent"). The Company seeks treble damages and an injunction against Synopsys for the sale and manufacture of products the Company alleges infringe the '328 Patent.

With respect to the above-referenced lawsuits, , we are currently unable to assess the possible extent of damages or other relief, if any, that might be awarded and no contingent liability was recorded as of October 2, 2005.

Publicly announced developments in our litigation matters may cause our stock price to decline sharply and suddenly. Other factors may reduce the market price of our common stock, and we are subject to ongoing risks of securities class action litigation related to volatility in the market price for our common stocks.

We may not be successful in defending some or all claims that may be brought against us. Regardless of the outcome, litigation can result in substantial expense and could divert the efforts of our management and technical personnel from our business. In addition, the ultimate resolution of the lawsuits could have a material adverse effect on our financial position, results of operations and cash flows and harm our ability to execute our business plan.

We may not be able to hire and/or retain the number of qualified personnel required for our business, particularly engineering personnel, which would harm the development and sales of our products and limit our ability to grow.

Competition in our industry for senior management, technical, sales, marketing and other key personnel is intense. If we are unable to retain our existing personnel, or attract and train additional qualified personnel, our growth may be limited due to a lack of capacity to develop and market our products.

In particular, we continue to experience difficulty in hiring and retaining skilled engineers with appropriate qualifications to support our growth strategy. Our success depends on our ability to identify, hire, train and retain qualified engineering personnel with experience in integrated circuit design. Specifically, we need to continue to attract and retain field application engineers to work with our direct sales force to technically qualify new sales opportunities and perform design work to demonstrate our products' capabilities to customers during the benchmark evaluation process. Competition for qualified engineers is intense, particularly in Silicon Valley where our headquarters is located.

Retaining our employees has become more challenging due to the decline in our stock price over the past several years. Many of the stock options held by our employees may have an exercise price that is significantly higher than the current trading price of our stock, and these "underwater" options do not serve their purpose as incentives for our employees to remain with Magma. Although, as discussed below, we have attempted to address this problem in part via a stock option exchange program that allowed eligible employees to exchange existing underwater options for options exercisable for a smaller number of shares at the price of $9.20 per share, we cannot guarantee that this program will satisfy our employees. In addition, the increased volatility of our stock price due to the pendency of, and developments in, the Synopsys litigation and above-referenced shareholder litigation may affect employee morale. If we lose the services of a significant number of our employees and/or if we cannot hire additional employees, we will be unable to increase our sales or implement or maintain our growth strategy.

Our success is highly dependent on the technical, sales, marketing and managerial contributions of key individuals, and we may be unable to recruit and retain these personnel.

We depend on our senior executives and certain key research and development and sales and marketing personnel, who are critical to our business. We do not have long-term employment agreements with our key employees, and we do not maintain any key person life insurance policies. Furthermore, our larger competitors may be able to offer more generous compensation packages to executives and key employees, and therefore we risk losing key personnel to those competitors. If we lose the services of any of our key personnel, our product development processes and sales efforts could be slowed. We may also incur increased operating expenses and be required to divert the attention of our senior executives to search for their replacements. The integration of our new executives or any new personnel could disrupt our ongoing operations.

Customer payment defaults may cause us to be unable to recognize revenue from backlog, and changes in the type of orders comprising backlog could affect the proportion of revenue recognized from backlog each quarter, which could have a material adverse effect on our financial condition and results of operations and on investor expectations.

A portion of our revenue backlog is variable based on volume of usage of our products by the customers or includes specific future deliverables or is recognized in revenue on a cash receipts basis. Management has estimated variable usage based on customers' forecasts, but there can be no assurance that these estimates will be realized. In addition, it is possible that customers from whom we expect to derive revenue from backlog will default and as a result we may not be able to recognize expected revenue from backlog. If a customer defaults and fails to pay amounts owed, or if the level of defaults increases, our bad debt expense is likely to increase. Any material payment default by our customers could have a material adverse effect on our financial condition and results of operations.

Our lengthy and unpredictable sales cycle, and the large size of some orders, makes it difficult for us to forecast revenue and increases the magnitude of quarterly fluctuations, which could harm our stock price.

Customers for our software products typically commit significant resources to evaluate available software. The complexity of our products requires us to spend substantial time and effort to assist potential customers in evaluating our software and in benchmarking it against our competition. As the complexity of the products we sell increases, we expect the sales cycle to lengthen. In addition, potential customers may be limited in their current spending by existing time-based licenses with their legacy vendors. In these cases, customers delay a significant new commitment to our software until the term of the existing license has expired. Also, because our products require a significant investment of time and cost by our customers, we must target those individuals within the customer's organization who are able to make these decisions on behalf of their companies. These individuals tend to be senior management in an organization, typically at the vice president level. We may face difficulty identifying and establishing contact with such individuals. Even after initial acceptance, the negotiation and documentation processes can be lengthy. Our sales cycle typically ranges between three and nine months, but can be longer. Any delay in completing sales in a particular quarter could cause our operating results to fall below expectations.

We rely on a small number of customers for a significant portion of our revenue, and our revenue could decline due to delays of customer orders or the failure of existing customers to renew licenses or if we are unable to maintain or develop relationships with current or potential customers.

Our business depends on sales to a small number of customers. We had one customer that accounted for 22% of our revenue in the six months ended October 2, 2005, as compared to 19% in the comparable period of prior year.

We expect that we will continue to depend upon a relatively small number of customers for a substantial portion of our revenue for the foreseeable future. If we fail to sell sufficient quantities of our products and services to one or more customers in any particular period, or if a large customer reduces purchases of our products or services, defers orders, or fails to renew licenses, our business and operating results will be harmed.

Most of our customers license our software under time-based licensing agreements, with terms that typically vary from 15 months to 48 months. Most of our license agreements automatically expire at the end of the term unless the customer renews the license with us or purchases a perpetual license. If our customers do not renew their licenses, we may not be able to maintain our current revenue or may not generate additional revenue. Some of our license agreements allow customers to terminate an agreement prior to its expiration under limited circumstances—for example, if our products do not meet specified performance requirements or goals. If these agreements are terminated prior to expiration or we are unable to collect under these agreements, our revenue may decline.

Some contracts with extended payment terms provide for payments which are weighted toward the later part of the contract term. Accordingly, as the payment terms are extended, the revenue from these contracts is not recognized evenly over the contract term, but is recognized as the lesser of the cumulative amounts due and payable or ratably for bundled agreements, and as amounts become due and payable for unbundled agreements, at each period end. Revenue recognized under these arrangements will be higher in the later part of the contract term, which puts our revenue recognition in the future at greater risk of the customer's continuing credit-worthiness. In addition, some of our customers have extended payment terms, which creates additional credit risk.

We compete against companies that hold a large share of the electronic design automation market and competition is increasing among EDA vendors as customers tightly control their EDA spending and use fewer vendors to meet their needs. If we cannot compete successfully, we will not gain market share and our revenue could decline.

We currently compete with companies that hold dominant shares in the electronic design automation market, such as Cadence and Synopsys. Each of these companies has a longer operating history and significantly

greater financial, technical and marketing resources than we do, as well as greater name recognition and larger installed customer bases. Our competitors are better able to offer aggressive discounts on their products, a practice they often employ. Our competitors offer a more comprehensive range of products than we do; for example, we do not offer logic simulation, full-feature custom layout editing, analog or mixed signal products, which can sometimes be an impediment to our winning a particular customer order. In addition, our industry has traditionally viewed acquisitions as an effective strategy for growth in products and market share and our competitors' greater cash resources and higher market capitalization may give them a relative advantage over us in buying companies with promising new chip design products or companies that may be too large for us to acquire without a strain on our resources.

Competition in the EDA Market has increased as customers rationalized their EDA spending by using products from fewer EDA vendors and continued consolidation in the electronic design automation market could intensify this trend. Also, many of our competitors, including Cadence and Synopsys, have established relationships with our current and potential customers and can devote substantial resources aimed at preventing us from establishing or enhancing our customer relationships. Competitive pressures may prevent us from obtaining new customers and gaining market share, may require us to reduce the price of products and services or cause us to lose existing customers, which could harm our business. To execute our business strategy successfully, we must continue our efforts to increase our sales worldwide. If we fail to do so in a timely manner or at all, we may not be able to gain market share and our business and operating results could suffer.

Also, a variety of small companies continue to emerge, developing and introducing new products. Any of these companies could become a significant competitor in the future. We also compete with the internal chip design automation development groups of our existing and potential customers. Therefore, these customers may not require, or may be reluctant to purchase, products offered by independent vendors.

Our competitors may develop or acquire new products or technologies that have the potential to replace our existing or new product offerings. The introduction of these new or additional products by competitors may cause potential customers to defer purchases of our products. If we fail to compete successfully, we will not gain market share and our business will fail.

We may not be successful in integrating the operations of acquired companies and acquired technology.

We expect to continuously evaluate the possibility of accelerating our growth through acquisitions, as is customary in the electronic design automation industry. Achieving the anticipated benefits of past and possible future acquisitions will depend in part upon whether we can integrate the operations, products and technology of acquired companies with our operations, products and technology in a timely and cost-effective manner. The process of integrating with acquired companies and acquired technology is complex, expensive and time consuming, and may cause an interruption of, or loss of momentum in, the product development and sales activities and operations of both companies. In addition, the earnout arrangements we use, and expect to continue to use, to consummate some of our acquisitions, pursuant to which we agreed to pay additional amounts of contingent consideration based on the achievement of certain revenue, bookings or product development milestones, can sometimes complicate integration efforts. We cannot be sure that any part or all of the integration will be accomplished on a timely basis, or at all. Assimilating previously acquired companies such as Silicon Metrics Corporation and Mojave, Inc., or any other companies we may seek to acquire in the future, involves a number of other risks, including, but not limited to:

- adverse effects on existing customer relationships, such as cancellation of orders or the loss of key customers;
- difficulties in integrating or an inability to retain key employees of the acquired company;
- the risk that earnouts based on revenue will prove difficult to administer due to the complexities of revenue recognition accounting;

- the risk that actions incentivized by earnout provisions will ultimately prove not to be in Magma's best interest as its interests may change over time;
- difficulties in integrating the operations of the acquired company, such as information technology resources, manufacturing processes, and financial and operational data;
- difficulties in integrating the technologies of the acquired company into our products;
- diversion of management attention;
- potential incompatibility of business cultures;
- potential dilution to existing stockholders if we have to incur debt or issue equity securities to pay for any future acquisitions; and
- additional expenses associated with the amortization of intangible assets.

Our operating results may be harmed if our customers do not adopt, or are slow to adopt, 65-nanometer design geometries.

Many Magma customers are currently working on 90-nanometer designs. Magma continues to work toward developing and enhancing its product line in anticipation of increased customer demand for 65-nanometer (sub-90 nanometer) design geometries. Similarly, Magma has acquired Mojave personnel and technology to better address customers' needs for designing and verifying semiconductors that are manufacturable with higher yield and performance, which is a key design parameter when moving to 65-nanometer geometries. Notwithstanding our efforts to support 65-nanometer geometries, customers may fail to adopt or may be slower to adopt 65-nanometer geometries and we may be unable to convince our customers to purchase our related software products. Accordingly, any revenues we receive from enhancements to our products or acquired technologies may be less than the development or acquisition costs. If customers fail to adopt 65-nanometer design geometries or are slow to adopt 65-nanometer design geometries, our operating results may be harmed.

Our operating results will be harmed if chip designers do not adopt Blast Fusion and products released under our Cobra initiative.

Blast Fusion has accounted for a significant majority of our revenue since our inception and we believe that revenue from Blast Fusion and related products will account for most of our revenue for the foreseeable future. In addition, we have dedicated significant resources to developing and marketing products developed under our Cobra development initiative. We must gain market penetration of Blast Fusion and products released under our Cobra initiative in order to achieve our growth strategy and financial success. Moreover, if integrated circuit designers do not continue to adopt Blast Fusion, our operating results will be significantly harmed.

If the industries into which we sell our products experience recession or other cyclical effects affecting our customers' research and development budgets, our revenue would be likely to decline.

Demand for our products is driven by new integrated circuit design projects. The demand from semiconductor and systems companies is uncertain and difficult to predict. Slower growth in the semiconductor and systems industries, a reduced number of design starts, reduction of electronic design automation budgets or continued consolidation among our customers would harm our business and financial condition. We have experienced slower growth in revenue than we anticipated as a result of the prolonged downturn and decreased spending by our customers in the semiconductor and systems industries.

The primary customers for our products are companies in the communications, computing, consumer electronics, networking and semiconductor industries. Any significant downturn in our customers' markets or in general economic conditions that results in the cutback of research and development budgets or the delay of software purchases would likely result in lower demand for our products and services and could harm our

business. For example, the United States economy, including the semiconductor industry, experienced a slowdown starting in 2000, which negatively impacted and may continue to impact our business and operating results. While the semiconductor industry experienced a moderate recovery in recent years, our customers have remained cautious, and it is not yet clear when increased R&D spending will occur. The continuing threat of terrorist attacks in the United States, the ongoing events in Iraq and other worldwide events including those in the Middle East have increased uncertainty in the United States economy. If the economy declines as a result of this economic, political and social turmoil, existing customers may delay their implementation of our software products and prospective customers may decide not to adopt our software products, either of which could negatively impact our business and operating results.

In recent years, some Asian countries have experienced significant economic difficulties, including devaluation and instability, business failures and a depressed business environment. These difficulties triggered a significant downturn in the semiconductor market, resulting in reduced budgets for chip design tools, which, in turn, negatively impacted us. We have experienced delayed orders and slower deployment of our products under new orders as a result of reduced budgets for chip design tools. In addition, the electronics industry has historically been subject to seasonal and cyclical fluctuations in demand for its products, and this trend may continue in the future. These industry downturns have been, and may continue to be, characterized by diminished product demand, excess manufacturing capacity and subsequent erosion of average selling prices.

Difficulties in developing and achieving market acceptance of new products and delays in planned release dates of our software products and upgrades may harm our business.

To succeed, we will need to develop innovative new products. We may not have the financial resources necessary to fund all required future innovations. Expanding into new technologies or extending our product line into areas we have not previously addressed may be more costly or difficult than anticipated. Also, any revenue that we receive from enhancements or new generations of our proprietary software products may be less than the costs of development. If we fail to develop and market new products in a timely manner, our reputation and our business will suffer.

Our costs of customer engagement and support are high, so our gross margin may decrease if we incur higher-than-expected costs associated with providing support services in the future or if we reduce our prices.

Because of the complexity of our products, we typically incur high field application engineering support costs to engage new customers and assist them in their evaluations of our products. If we fail to manage our customer engagement and support costs, our operating results could suffer. In addition, our gross margin may decrease if we are unable to manage support costs associated with the services revenue we generate or if we reduce prices in response to competitive pressure.

Product defects could cause us to lose customers and revenue, or to incur unexpected expenses.

Our products depend on complex software, both internally developed and licensed from third parties. Our customers may use our products with other companies' products, which also contain complex software. If our software does not meet our customers' performance requirements, our customer relationships may suffer. Also, a limited number of our contracts include specified ongoing performance criteria. If our products fail to meet these criteria, it may lead to termination of these agreements and loss of future revenue. Complex software often contains errors. Any failure or poor performance of our software or the third-party software with which it is integrated could result in:

- delayed market acceptance of our software products;
- delays in product shipments;
- unexpected expenses and diversion of resources to identify the source of errors or to correct errors;

- damage to our reputation;
- delayed or lost revenue; and
- product liability claims.

Our product functions are often critical to our customers, especially because of the resources our customers expend on the design and fabrication of integrated circuits. Many of our licensing agreements contain provisions to provide a limited warranty, which provides the customer with a right of refund for the license fees if we are unable to correct errors reported during the warranty period. If our contractual limitations are unenforceable in a particular jurisdiction or if we are exposed to claims that are not covered by insurance, a successful claim could harm our business. We currently carry insurance coverages and limits that we believe are consistent with similarly situated companies within the EDA industry.

Much of our business is international, which exposes us to risks inherent to doing business internationally that could harm our business. We also intend to expand our international operations. If our revenue from this expansion does not exceed the expenses associated with this expansion, our business and operating results could suffer.

We generated 27% of our total revenue from sales outside North America for the six months of fiscal 2006, compared to 41% for the same period in the prior year. While most of our international sales to date have been denominated in U.S. dollars, our international operating expenses have been denominated in foreign currencies. As a result, a decrease in the value of the U.S. dollar relative to the foreign currencies could increase the relative costs of our overseas operations, which could reduce our operating margins.

The expansion of our international operations includes the maintenance of sales offices in Europe, the Middle East, and the Asia Pacific region. If our revenue from international operations does not exceed the expense of establishing and maintaining our international operations, our business could suffer. Additional risks we face in conducting business internationally include:

- difficulties and costs of staffing and managing international operations across different geographic areas;
- changes in currency exchange rates and controls;
- uncertainty regarding tax and regulatory requirements in multiple jurisdictions;
- the possible lack of financial and political stability in foreign countries, preventing overseas sales growth;
- on-going events in Iraq; and
- the effects of terrorist attacks in the United States and any related conflicts or similar events worldwide.

Future changes in accounting standards, specifically changes affecting revenue recognition, could cause adverse unexpected revenue fluctuations.

Future changes in accounting standards for interpretations thereof, specifically those changes affecting software revenue recognition, could require us to change our methods of revenue recognition. These changes could result in deferral of revenue recognized in current periods to subsequent periods or in accelerated recognition of deferred revenue to current periods, each of which could cause shortfalls in meeting the expectations of investors and securities analysts. Our stock price could decline as a result of any shortfall. Implementation of internal controls reporting and attestation requirements, as further described below, will impose additional financial and administrative obligations on us and will cause us to incur substantial implementation costs from third party consultants, which could adversely affect our results.

Changes in laws and regulations that affect the governance of public companies have increased our operating expenses and will continue to do so.

Recently enacted changes in the laws and regulations affecting public companies, including the provisions of the Public Company Accounting Reform and Investor Protection Act of 2002 (the "Sarbanes-Oxley Act of 2002") and the listing requirements for The Nasdaq Stock Market have imposed new duties on us and on our executives, directors, attorneys and independent registered public accounting firms. In order to comply with these new rules, we have hired additional personnel and use additional outside legal, accounting and advisory services, all of which have increased and may continue to increase our operating expenses over time. In particular, we have incurred and will continue to incur additional administrative expenses relating to the implementation of Section 404 of the Sarbanes-Oxley Act of 2002, which requires the implementation and maintenance of an effective system of internal control over financial reporting, and, annual certification of Section 404 compliance by our independent registered public accounting firm. For example, we have incurred significant expenses and will continue to incur expenses in connection with the implementation, documentation and continued testing of our internal control systems. Management time associated with these compliance efforts necessarily reduces time available for other operating activities, which could adversely affect operating results. For the year ended March 31, 2005, our independent registered public accounting firm certified that we were in compliance with the provision of Section 404 relating to effective internal control over financial reporting, however, our internal control obligations are ongoing and subject to continued review and testing. If we are unable to maintain full and timely compliance with the foregoing regulatory requirements, we could be required to incur additional costs, expend additional management time on remedial efforts and make related public disclosures that could adversely affect our stock price and result in securities litigation.

The effectiveness of disclosure controls is inherently limited.

We do not expect that our disclosure controls and procedures, or our internal control over financial reporting, will prevent all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system objectives will be met. The design of a control system must also reflect applicable resource constraints, and the benefits of controls must be considered relative to their costs. As a result of these inherent limitations, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Magma have been detected. Failure of the control systems to prevent error or fraud could materially adversely impact our financial results and our business. Management assessed the effectiveness of our internal control over financial reporting as of October 2, 2005, and this assessment identified a material weakness in our internal control over financial reporting related to the completeness and accuracy of our accounting for stock-based compensation expenses incurred during the second quarter ended October 2, 2005. As of the date of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were ineffective because of this material weakness in our internal control over financial reporting. Failing to remedy this material weakness could have a material adverse effect on our business, and could adversely affect the price of our common stock and lead to expensive litigation. Our efforts to remedy this material weakness could cause us to incur significant additional costs and expend significant additional management time on remedial efforts, which could also impact our financial performance.

Forecasting the Company's tax rates is complex and subject to uncertainty.

Management must make significant assumptions, judgments and estimates to determine our current provision for income taxes, deferred tax assets and liabilities, and any valuation allowance that may be recorded against our deferred tax assets. These assumptions, judgments and estimates are difficult to make due to their complexity and the relevant tax law is often changing. Our future effective tax rates could be adversely affected by the following:

- an increase in expenses not deductible for tax purposes, including deferred stock-based compensation and write-offs of acquired in-process research and development;

- changes in the valuation of our deferred tax assets and liabilities;
- future changes in ownership as defined by Internal Revenue Code Sections 382 and 383 which may limit realization of certain assets;
- changes in forecasts of pre-tax profits and losses by jurisdiction used to estimate tax expense by jurisdiction;
- assessment of additional taxes as a result of federal, state, or foreign tax examinations; or
- changes in tax laws or interpretations of such tax laws.

Our success will depend on our ability to keep pace with the rapidly evolving technology standards of the semiconductor industry. If we are unable to keep pace with rapidly changing technology standards, our products could be rendered obsolete, which would cause our operating results to decline.

The semiconductor industry has made significant technological advances. In particular, recent advances in deep sub-micron technology have required electronic design automation companies to continuously develop or acquire new products and enhance existing products. The evolving nature of our industry could render our existing products and services obsolete. Our success will depend, in part, on our ability to:

- enhance our existing products and services;
- develop and introduce new products and services on a timely and cost-effective basis that will keep pace with technological developments and evolving industry standards;
- address the increasingly sophisticated needs of our customers; and
- acquire other companies that have complementary or innovative products.

If we are unable, for technical, legal, financial or other reasons, to respond in a timely manner to changing market conditions or customer requirements, our business and operating results could be seriously harmed.

If we fail to offer and maintain competitive stock option packages for our employees, or if our stock price declines materially for a protracted period of time, we might have difficulty retaining our employees and our business may be harmed.

In today's competitive technology industry, employment decisions of highly skilled personnel are influenced by stock option packages, which offer incentives above traditional compensation only where there is a consistent, long-term upward trend over time of a company's stock price. Our stock price has declined significantly over the past several years due to market conditions and has recently been negatively affected by uncertainty surrounding the outcome of our patent litigation with Synopsys, Inc. (discussed below under Part II, Item 1, "Legal Proceedings"). As a result, many of the options held by our non-executive employees have an exercise price significantly above the current trading price of our stock; on October 2, 2005 approximately 85% of the options held by our non-executive employees were "underwater."

On June 22, 2005, our stockholders approved a stock option exchange program ("Exchange Program") allowing non-executive employees holding options to purchase our common stock at exercise prices greater than or equal to $10.50 to exchange those options for a smaller number of new options at an exercise price equal to fair market value on the date of grant. Magma implemented this Exchange Program, and the date of grant was August 22, 2005, at which date the closing trading price of our stock was $9.20 per share. Therefore, the exercise price for new options under this Exchange Program is $9.20 per share. If this exercise price of $9.20 per share or the terms of the Exchange Program are not satisfactory to employees who participate in the Exchange Program, or, if our stock price drops after August 22, 2005, our ability to retain employees could be affected.

If our stock price continues to decline in the future due to market conditions, investors' perceptions of the technology industry or managerial or performance problems we have, we may be forced to grant additional options to retain employees. This in turn could result in:

- immediate and substantial dilution to investors resulting from the grant of additional options necessary to retain employees; and
- compensation charges against the company, which would negatively impact our operating results.

In addition, the new accounting requirements for employee stock options discussed below may adversely affect our option grant practices and our ability to recruit and retain employees.

When the accounting treatment for employee stock options changes, our reported results of operations will likely be adversely affected and we may be forced to change our employee compensation and benefits practices.

We currently account for the issuance of employee stock options under principles that do not require us to record compensation expense for options granted at fair market value. In December 2004, the FASB issued SFAS 123R, "Share-Based Payment," which eliminates the ability to account for share-based compensation transactions using APB 25, and generally requires instead that such transactions be accounted for using a fair-value based method. Under SFAS 123R, companies are required to recognize an expense for compensation cost related to share-based payment arrangements including stock options and employee stock purchase plans. We will be required to adopt the new rules no later than the first quarter of our fiscal year 2007. We are currently assessing the impact of the adoption of SFAS 123R on our business practices; however, this change in accounting treatment will likely adversely affect our reported results of operations and hinder our ability to achieve profitability. Accordingly, we may consider changing our employee compensation practices, and those changes could make it harder for us to retain existing employees and attract qualified candidates.

If our sales force compensation arrangements are not designed effectively, we may lose sales personnel and resources.

Designing an effective incentive compensation structure for our sales force is critical to our success. We have experimented, and continue to experiment, with different systems of sales force compensation. If our incentives are not well designed, we may experience reduced revenue generation, and we may also lose the services of our more productive sales personnel, either of which would reduce our revenue or potential revenue.

Fluctuations in our growth place a strain on our management systems and resources, and if we fail to manage the pace of our growth our business could be harmed.

Periods of growth followed by efforts to realign costs when revenue growth is slower than anticipated have placed a strain on our management, administrative and financial resources. For example, in fiscal year 2005 and the third quarter of fiscal year 2003, we decreased our workforce by 23 and 32 employees, respectively. Over time we have significantly expanded our operations in the United States and internationally, and we plan to continue to expand the geographic scope of our operations. To pace the growth of our operations with the growth in our revenue, we must continue to improve administrative, financial and operations systems, procedures and controls. Failure to improve our internal procedures and controls could hinder our efforts to adequately manage our growth, disrupt operations, lead to deficiencies under the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, and ultimately harm to our business.

If chip designers and manufacturers do not integrate our software into existing design flows, or if other software companies do not cooperate in working with us to interface our products with their design flows, demand for our products may decrease.

To implement our business strategy successfully, we must provide products that interface with the software of other electronic design automation software companies. Our competitors may not support our or our

customers' efforts to integrate our products into their existing design flows. We must develop cooperative relationships with competitors so that they will work with us to integrate our software into a customer's design flow. Currently, our software is designed to interface with the existing software of Cadence, Synopsys and others. If we are unable to convince customers to adopt our software products instead of those of competitors offering a broader set of products, or if we are unable to convince other software companies to work with us to interface our software with theirs to meet the demands of chip designers and manufacturers, our business and operating results will suffer.

We may not obtain sufficient patent protection, which could harm our competitive position and increase our expenses.

Our success and ability to compete depends to a significant degree upon the protection of our software and other proprietary technology. We currently have a number of issued patents in the United States, but this number is relatively few in relation to our competitors.

These legal protections afford only limited protection for our technology. In addition, rights that may be granted under any patent application that may issue in the future may not provide competitive advantages to us. Further, patent protection in foreign jurisdictions where we may need this protection may be limited or unavailable. It is possible that:

- our pending U.S. and non-U.S. patents may not be issued;
- competitors may design around our present or future issued patents or may develop competing non-infringing technologies;
- present and future issued patents may not be sufficiently broad to protect our proprietary rights; and
- present and future issued patents could be successfully challenged for validity and enforceability.

We believe the patent portfolios of our competitors are far larger than ours, and this may increase the risk that they may sue us for patent infringement and may limit our ability to counterclaim for patent infringement or settle through patent cross-licenses.

We rely on trademark, copyright and trade secret laws and contractual restrictions to protect our proprietary rights, and if these rights are not sufficiently protected, it could harm our ability to compete and generate income.

To establish and protect our proprietary rights, we rely on a combination of trademark, copyright and trade secret laws, and contractual restrictions, such as confidentiality agreements and licenses. Our ability to compete and grow our business could suffer if these rights are not adequately protected. We seek to protect our source code for our software, documentation and other written materials under trade secret and copyright laws. We license our software pursuant to agreements, which impose certain restrictions on the licensee's ability to utilize the software. We also seek to avoid disclosure of our intellectual property by requiring employees and consultants with access to our proprietary information to execute confidentiality agreements. Our proprietary rights may not be adequately protected because:

- laws and contractual restrictions in U.S. and foreign jurisdictions may not prevent misappropriation of our technologies or deter others from developing similar technologies;
- competitors may independently develop similar technologies and software code;
- for some of our trademarks, federal U.S. trademark protection may be unavailable to us;
- our trademarks may not be protected or protectable in some foreign jurisdictions;
- the validity and scope of our U.S. and foreign trademarks could be successfully challenged; and
- policing unauthorized use of our products and trademarks is difficult, expensive and time-consuming, and we may be unable to determine the extent of this unauthorized use.

The laws of some countries in which we market our products may offer little or no protection of our proprietary technologies. Reverse engineering, unauthorized copying or other misappropriation of our proprietary technologies could enable third parties to benefit from our technologies without paying us for it, which would harm our competitive position and market share.

Our directors, executive officers and principal stockholders own a substantial portion of our common stock and this concentration of ownership may allow them to elect most of our directors and could delay or prevent a change in control of Magma.

Our directors, executive officers and stockholders who currently own over 5% of our common stock beneficially own a substantial portion of our outstanding common stock. These stockholders, in a combined vote, will be able to significantly influence all matters requiring stockholder approval. For example, they may be able to elect most of our directors, delay or prevent a transaction in which stockholders might receive a premium over the market price for their shares or prevent changes in control or management.

We may need additional capital in the future, but there is no assurance that funds would be available on acceptable terms.

In the future we may need to raise additional capital in order to achieve growth or other business objectives. This financing may not be available in sufficient amounts or on terms acceptable to us and may be dilutive to existing stockholders. If adequate funds are not available or are not available on acceptable terms, our ability to expand, develop or enhance services or products, or respond to competitive pressures would be limited.

Our certificate of incorporation, bylaws and Delaware corporate law contain anti-takeover provisions which could delay or prevent a change in control even if the change in control would be beneficial to our stockholders. We could also adopt a stockholder rights plan, which could also delay or prevent a change in control.

Delaware law, as well as our certificate of incorporation and bylaws, contain anti-takeover provisions that could delay or prevent a change in control of our company, even if the change of control would be beneficial to the stockholders. These provisions could lower the price that future investors might be willing to pay for shares of our common stock. These anti-takeover provisions:

- authorize the Board of Directors without prior stockholder approval to create and issue preferred stock that can be issued increasing the number of outstanding shares and deter or prevent a takeover attempt;
- prohibit stockholder action by written consent, thereby requiring all stockholder actions to be taken at a meeting of our stockholders;
- establish a classified Board of Directors requiring that not all members of the board be elected at one time;
- prohibit cumulative voting in the election of directors, which would otherwise allow less than a majority of stockholders to elect director candidates;
- limit the ability of stockholders to call special meetings of stockholders; and
- require advance notice requirements for nominations for election to the Board of Directors and proposals that can be acted upon by stockholders at stockholder meetings.

In addition, Section 203 of the Delaware General Corporation Law and the terms of our stock option plans may discourage, delay or prevent a change in control of our company. That section generally prohibits a Delaware corporation from engaging in a business combination with an interested stockholder for three years after the date the stockholder became an interested stockholder. Also, our stock option plans include change-in-control provisions that allow us to grant options or stock purchase rights that will become vested immediately upon a change in control of us.

The board of directors also has the power to adopt a stockholder rights plan, which could delay or prevent a change in control even if the change in control appeared to be beneficial to stockholders. These plans, sometimes called "poison pills," are sometimes criticized by institutional investors or their advisors and could affect our rating by such investors or advisors. If the board were to adopt such a plan it might have the effect of reducing the price that new investors are willing to pay for shares of our common stock.

We are subject to risks associated with changes in foreign currency exchange rates.

We transact some portions of our business in various foreign currencies. Accordingly, we are subject to exposure from adverse movements in foreign currency exchange rates. This exposure is primarily related to operating expenses in the United Kingdom, Europe and Japan, which are denominated in the respective local currencies. As of October 2, 2005, we had no hedging contracts outstanding. We do not currently use financial instruments to hedge operating expenses denominated in Euro, British Pounds and Japanese Yen. We assess the need to utilize financial instruments to hedge currency exposures on an ongoing basis.

The convertible notes we issued in May 2003 are debt obligations that must be repaid in cash in May 2008 if they are not converted into our common stock at an earlier date, which is unlikely to occur if the price of our common stock does not exceed the conversion price.

In May 2003, we issued $150.0 million principal amount of our zero coupon convertible notes due May 2008. In May 2005, we repurchased, in privately negotiated transactions, $44.5 million face amount (or approximately 29.7 percent of the total) of these notes at an average discount to face value of approximately 22 percent. Magma spent an aggregate of approximately $34.8 million on the repurchases. The repurchase leaves approximately $105.5 million aggregate principal amount of convertible subordinated notes outstanding. We will be required to repay that principal amount in full in May 2008 unless the holders of those notes elect to convert them into our common stock before the repayment date. The conversion price of the notes is $22.86 per share. If the price of our common stock does not rise above that level, conversion of the notes is unlikely and we would be required to repay the principal amount of the notes in cash. There have been previous quarters in which we have experienced shortfalls in revenue and earnings from levels expected by securities analysts and investors, which have had an immediate and significant adverse effect on the trading price of our common stock. In addition, the stock market in recent years has experienced extreme price and trading volume fluctuations that often have been unrelated or disproportionate to the operating performance of individual companies. These broad market fluctuations may adversely affect the price of our stock, regardless of our operating performance. Because the notes are convertible into shares of our common stock, volatility or depressed prices for our common stock could have a similar effect on the trading price of the notes.

Hedging transactions and other transactions may affect the value of our common stock and our convertible notes.

We entered into hedging arrangements with Credit Suisse First Boston International at the time we issued our convertible notes, with the objective of reducing the potential dilutive effect of issuing common stock upon conversion of the notes. At the time of our May 2005 repurchase of our zero coupon convertible notes, a portion of the hedging arrangements were retired. These hedging arrangements are likely to have caused Credit Suisse First Boston International and others to take positions in our common stock in secondary market transactions or to enter into derivative transactions at or after the sale of the notes. Any market participants entering into hedging arrangements are likely to modify their hedge positions from time to time prior to conversion or maturity of the notes by purchasing and selling shares of our common stock or other securities, which may increase the volatility and reduce the market price of our common stock.

Our convertible notes are subordinated and there are no financial covenants in the indenture.

Our convertible notes are general unsecured obligations of Magma and are subordinated in right of payment to all of our existing and future senior indebtedness, which we may incur in the future. In the event of our

bankruptcy, liquidation or reorganization, or upon acceleration of the notes due to an event of default under the indenture and in certain other events, our assets will be available to pay obligations on the notes only after all senior indebtedness has been paid. As a result, there may not be sufficient assets remaining to pay amounts due on any or all of the outstanding notes. In addition, we will not make any payments on the notes in the event of payment defaults or other specified defaults on our designated senior indebtedness.

Neither we nor our subsidiaries are restricted under the indenture for the notes from incurring additional debt, including senior indebtedness. If we or our subsidiaries incur additional debt or other liabilities, our ability to pay our obligations on the notes could be further adversely affected. We expect that we and our subsidiaries from time to time will incur additional indebtedness and other liabilities.

We may be unable to meet the requirements under the indenture to purchase our convertible notes upon a change in control.

Upon a change in control, which is defined in the indenture to include some cash acquisitions and private company mergers, note holders may require us to purchase all or a portion of the notes they hold. If a change in control were to occur, we might not have enough funds to pay the purchase price for all tendered notes. Future credit agreements or other agreements relating to our indebtedness might prohibit the redemption or repurchase of the notes and provide that a change in control constitutes an event of default. If a change in control occurs at a time when we are prohibited from purchasing the notes, we could seek the consent of our lenders to purchase the notes or could attempt to refinance this debt. If we do not obtain a consent, we could not purchase the notes. Our failure to purchase tendered notes would constitute an event of default under the indenture, which might constitute a default under the terms of our other debt. In such circumstances, or if a change in control would constitute an event of default under our senior indebtedness, the subordination provisions of the indenture would possibly limit or prohibit payments to note holders. Our obligation to offer to purchase the notes upon a change in control would not necessarily afford note holders protection in the event of a highly leveraged transaction, reorganization, merger or similar transaction involving us.

Failure to obtain export licenses could harm our business by preventing us from transferring our technology outside of the United States.

We are required to comply with U.S. Department of Commerce regulations when shipping our software products and/or transferring our technology outside of the United States or to certain foreign nationals. We believe we have complied with applicable export regulations, however, these regulations are subject to change, and, future difficulties in obtaining export licenses for current, future developed and acquired products and technology could harm our business, financial conditions and operating results.

Our business operations may be adversely affected in the event of an earthquake or other natural disaster.

Our corporate headquarters and much of our research and development operations are located in Silicon Valley, California, which is an area known for its seismic activity. An earthquake, fire or other significant natural disaster could have a material adverse impact on our business, financial condition and/or operating results.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. This is accomplished by investing in widely diversified short-term and long-term investments, consisting primarily of investment grade securities, substantially all of which mature within the next twenty-four months. As of October 2, 2005, a hypothetical 100 basis point increase in interest rates would result in approximately a $24,000 decline in the fair value of our available-for-sale securities.

The fair value of our fixed rate long-term debt is sensitive to interest rate changes. Interest rate changes would result in increases or decreases in the fair value of our debt, due to differences between market interest rates and rates in effect at the inception of our debt obligation. Changes in the fair value of our fixed rate debt have no impact on our cash flows or consolidated financial statements.

Credit Risk

We completed an offering on May 22, 2003 of $150.0 million principal amount of convertible subordinated notes due May 15, 2008. Concurrent with the issuance of the convertible notes, we entered into convertible bond hedge and warrant transactions with respect to our common stock, the exposure for which is held by Credit Suisse First Boston International. Both the bond hedge and warrant transactions may be settled at our option either in cash or net shares and expire on May 15, 2008. The transactions are expected to reduce the potential dilution from conversion of the notes. Subject to the movement in the share price of our common stock, we could be exposed to credit risk in the settlement of these options in our favor. Based on a review of the possible net settlements and the credit strength of Credit Suisse First Boston International and its affiliates, we believe that we do not have a material exposure to credit risk arising from these option transactions.

In April 2005, the Company repurchased $44.5 million face value of its convertible notes for $34.8 million. In doing so, the Company liquidated investments that generated a realized loss of approximately $0.7 million. A portion of the hedge and warrant transactions entered into by Magma in 2003 was terminated in connection with the repurchase. The Company believes that it was in the best interests of the stockholders to reduce the balance sheet debt despite the one-time loss resulting from the liquidation of marketable securities.

Foreign Currency Exchange Rate Risk

A majority of our revenue, expense, and capital purchasing activities are transacted in U.S. dollars. However, we transact some portions of our business in various foreign currencies, primarily related to a portion of revenue in Japan and operating expenses in Europe, Japan and Asia-Pacific. Accordingly, we are subject to exposure from adverse movements in foreign currency exchange rates. As of October 2, 2005, we had no currency hedging contracts outstanding. We do not currently use financial instruments to hedge revenue and operating expenses denominated in foreign currencies. We assess the need to utilize financial instruments to hedge currency exposures on an ongoing basis.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that the information required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required financial disclosures.

As of the end of the period covered by this report, we performed an evaluation, under the supervision of the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e). As of the date of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were ineffective because of the material weakness in our internal control over financial reporting described below. Notwithstanding the existence of this material weakness, our management, including our Chief Executive Officer and Chief Financial Officer, believes that the consolidated financial statements included in this report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles ("GAAP"). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As of October 2, 2005, we did not maintain effective controls over the completeness and accuracy of our accounting for stock-based compensation. Specifically, supervisory review and approval controls over stock-based compensation expenses for our stock option exchange program and the Mojave earn-outs compensation were not effective to ensure that the amounts were in accordance with GAAP. This control deficiency resulted in adjustments to stock-based compensation expense for the quarter ended October 2, 2005. Additionally, this control deficiency could result in a misstatement of stock-based compensation expense that would result in a material misstatement to the Company's annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, we have concluded that this control deficiency constitutes a material weakness.

Changes in Internal Control over Financial Reporting

We assign a high priority to the improvement of our internal control over financial reporting. We will consider contracting additional technical accounting staff/outside consultants in our accounting and reporting function as we believe appropriate, and we have updated our accounting checklist to enhance our internal controls.

Other than as described above, there have been no changes in our internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f), during the quarter ended October 2, 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Synopsys, Inc. v. Magma Design Automation, Inc., Civil Action No. C04-03923 ("MMC"), United States District Court, Northern District of California. In this action, filed September 17, 2004, Synopsys has sued the Company for alleged infringement of U.S. Patent Nos. 6,378,114 ("the '114 Patent"), 6,453,446 ("the '446 Patent"), and 6,725,438 ("the '438 Patent"). The patents-in-suit relate to methods for designing integrated circuits. The Complaint seeks unspecified monetary damages, injunctive relief, trebling of damages, fees and costs, and the imposition of a constructive trust for the benefit of Synopsys over any profits, revenues or other benefits allegedly obtained by the Company as a result of its alleged infringement of the patents-in-suit.

On October 21, 2004, the Company filed its answer and counterclaims ("Answer") to the Complaint. On November 10, 2004 Synopsys filed motions to strike and dismiss certain affirmative defenses and counterclaims in the Answer. On November 24, 2004 the Company filed an Amended Answer and Counterclaims ("Amended Answer"). By order dated November 29, 2004, the Court denied Synopsys' motions as moot in light of the Amended Answer. On December 10, 2004, Synopsys moved to strike and dismiss certain affirmative defenses and counterclaims in the Amended Answer. By order dated January 20, 2005, the Court denied in part and granted in part Synopsys' motion. In its pretrial preparation order dated January 21, 2005, the Court set forth a schedule for the case which, among other things, sets trial for April 24, 2006. Discovery is ongoing.

On February 3, 2005, Synopsys filed its Reply to the Amended Answer. On March 17, 2005, Synopsys filed a First Amended Complaint, which asserts seven causes of action against the Company and/or Lukas van Ginneken: (1) patent infringement (against both defendants), (2) breach of contract (against van Ginneken), (3) inducing breach of contract (against the Company), (4) fraud (against the Company), (5) conversion (against both defendants), (6) unjust enrichment/constructive trust (against both defendants), and (7) unfair competition (against both defendants). Synopsys seeks injunctive relief, declaratory relief, at least $100 million in damages, trebling of damages, punitive damages, fees and costs, and the imposition of a constructive trust for the benefit of Synopsys over any profits, revenues or other benefits allegedly obtained by the Company as a result of its alleged exploitation of the alleged inventions in the patents-in-suit. On April 1, 2005, the Company filed a motion to dismiss the third through seventh causes of action. This motion was granted in part and denied in part by order dated May 18, 2005.

On April 11, 2005, Synopsys voluntarily dismissed van Ginneken from the lawsuit without prejudice. Also on April 11, 2005, Synopsys filed against the Company a motion for partial summary judgment establishing unfair competition and a motion for partial summary judgment based on the doctrine of assignor estoppel.

On June 7, 2005, Synopsys filed a Second Amended Complaint that asserts six causes of action against the Company: (1) patent infringement, (2) inducing breach of contract/interference with contractual relations, (3) fraud, (4) conversion, (5) unjust enrichment/constructive trust/quasi-contract, and (6) unfair competition. Synopsys seeks injunctive relief, declaratory relief, at least $100 million in damages, trebling of damages, punitive damages, fees and costs, and the imposition of a constructive trust for the benefit of Synopsys over any profits, revenues or other benefits allegedly obtained by the Company as a result of its alleged exploitation of the alleged inventions in the patents-in-suit. On June 10, 2005, Magma moved for summary judgment as to the second through sixth causes of action in the Second Amended Complaint. On June 21, 2005, the Company moved to dismiss the third cause of action for fraud in the Second Amended Complaint and moved to strike certain allegations in the Second Amended Complaint. The court granted the Company's motion to dismiss and strike by order dated July 15, 2005.

On July 1, 2005, the Court granted Synopsys's motion for partial summary judgment regarding assignor estoppel, dismissing Magma's affirmative defenses and counterclaim alleging the invalidity of the '114 Patent. On July 14, 2005, the court vacated the hearings on Magma's motion for summary judgment on the second through sixth causes of action in the Second Amended Complaint and Synopsys's motion for partial summary

judgment establishing unfair competition. The court stated that it would reset the motions for hearing, if necessary, after the claims construction hearing scheduled for August 15, 2005.

On July 29, 2005, Synopsys moved to preliminarily enjoin the Company from abandoning or dedicating to the public the '446 Patent or the '438 Patent. Also on July 29, 2005, Synopsys moved for partial summary judgment seeking dismissal of certain counterclaims and defenses asserted by the Company on the grounds of estoppel by contract. On September 16, 2005, Synopsys filed a revised motion for preliminary injunction. On September 30, 2005, the Company filed its oppositions to Synopsys's preliminary injunction motion and estoppel by contract motion. Both motions are scheduled to be heard December 2, 2005.

On August 3, 2005, Synopsys filed a Third Amended Complaint that asserts six causes of action against the Company: (1) patent infringement, (2) inducing breach of contract/interference with contractual relations, (3) fraud, (4) conversion, (5) unjust enrichment/constructive trust/quasi-contract, and (6) unfair competition. Synopsys seeks injunctive relief, declaratory relief, at least $100 million in damages, trebling of damages, punitive damages, fees and costs, and the imposition of a constructive trust for the benefit of Synopsys over any profits, revenues or other benefits allegedly obtained by the Company as a result of its alleged exploitation of the alleged inventions in the patents-in-suit.

On August 30, 2005, the Court issued a temporary restraining order against the Company restraining and enjoining the Company from taking any steps in the United States Patent and Trademark Office to abandon, suspend or disclaim the '446 and '438 Patents, failing or refusing to pay the maintenance fees for the '446 and '438 Patents, or seeking reexamination of the '446 and '438 Patents. The temporary restraining order will remain in effect until the hearing on Synopsys's motion for a preliminary injunction scheduled for December 2, 2005.

On September 2, 2005, the Company filed an Answer and Counterclaims to Synopsys's Third Amended Complaint. In that pleading, the Company alleges, *inter alia*, that IBM is a joint owner of the patents-in-suit and that, as a result, the Company cannot be liable for infringement because (1) Synopsys lacks standing to assert the patents-in-suit against Magma, and (2) the patents-in-suit are licensed to Magma by IBM.

On October 19, 2005, the Court granted in part and denied in part Synopsys's motion to strike certain affirmative defenses and to dismiss certain counterclaims in the Company's Answer and Counterclaims to Synopsys's Third Amended Complaint. The Court dismissed without leave to amend the Company's counterclaims seeking correction of inventorship of the '446 and '438 Patents. The Court also struck without leave to amend the Company's affirmative defenses of (1) invalidity of the '446 and '438 Patents based on failure to name all inventors, (2) unenforceability of the '446 and '438 patents due to inequitable conduct, and (3) unclean hands. The Court struck with leave to amend the Company's affirmative defenses of invalidity of the '446 and '438 Patents based on 35 U.S.C. §§ 102, 103 and 112, as well as the Company's affirmative defense that Synopsys is not the owner of any invention defined by the claims of the '446 and '438 Patents.

On October 24, 2005, the Company filed a motion for summary judgment as to the first cause of action (for patent infringement) in Synopsys's Third Amended Complaint on the grounds that IBM is an owner of all the patents-in-suit. Also on October 24, 2005, Synopsys filed (1) a motion for partial summary judgment to dismiss the Company's joint ownership defenses and counterclaims, and (2) a motion for partial summary judgment to dismiss allegations of co-ownership based on judicial and quasi-estoppel. All three motions are scheduled to be heard on December 2, 2005.

The Company intends to vigorously defend against the claims asserted by Synopsys and to fully enforce its rights against Synopsys. However, the results of any litigation are inherently uncertain and the Company can not assure that it will be able to successfully defend against the Complaint. A favorable outcome for Synopsys could have a material adverse effect on the Company's financial position, results of operations or cash flows. The Company is currently unable to assess the extent of damages and/or other relief, if any, that could be awarded to Synopsys; therefore, no contingent liability has been recorded on the Company's condensed consolidated balance sheet as of October 2, 2005.

On April 18, 2005, Synopsys, Inc. filed an action against the Company in Germany at the Landgericht München I (District Court in Munich) seeking to obtain ownership of the European patent application corresponding to the Company's '446 Patent. The action has been stayed pending the outcome of the above-referenced Synopsys action filed in the United States.

On July 29, 2005, Synopsys, Inc. filed an action against the Company in Japan in Civil Department No. 40 of the Tokyo District Court seeking to obtain ownership of the Japanese patent application corresponding to the Company's '446 Patent. The Company has engaged counsel in Japan and will seek to stay this action pending the outcome of the above-referenced Synopsys action filed in the United States.

On June 13, 2005, a putative shareholder class action lawsuit captioned *The Cornelia I. Crowell GST Trust vs. Magma Design Automation, Inc., Rajeev Madhavan, Gregory C. Walker and Roy E. Jewell.*, No. C 05 02394, was filed in U.S. District Court, Northern District of California. The complaint alleges that defendants failed to disclose information regarding the risk of Magma infringing intellectual property rights of Synopsys, Inc., in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and prays for unspecified damages. The Company is currently unable to assess the possible range or extent of damages and/or other relief, if any, that could be awarded to the shareholder class; therefore, no contingent liability has been recorded on the Company's condensed consolidated balance sheet as of October 2, 2005. The ultimate resolution of this matter or other third party assertions could have a material adverse effect on the Company's financial position, results of operations or cash flows.

On July 26, 2005, a putative derivative complaint captioned *Susan Willis v. Magma Design Automation, Inc. et al.*, No. 1-05-CV-045834, was filed in the Superior Court of the State of California for the County of Santa Clara. The Complaint seeks unspecified damages purportedly on behalf of the Company for alleged breaches of fiduciary duties by various directors and officers, as well as for alleged violations of insider trading laws by executives during a period between October 23, 2002 and April 12, 2005. Defendants have demurred to the Complaint, and a hearing is scheduled for December 2005. The Company is currently unable to assess the possible range or extent of damages and/or other relief, if any, that could be awarded; therefore, no contingent liability has been recorded on the Company's condensed consolidated balance sheet as of October 2, 2005. The ultimate resolution of this matter or other third party assertions could have a material adverse effect on the Company's financial position, results of operations or cash flows.

On September 26, 2005, Synopsys, Inc. filed an action against the Company in the Superior Court of the State of California in and for the County of Santa Clara, entitled *Synopsys, Inc. v. Magma Design Automation, Inc., et al.*, Case Number 105 CV 049638. Synopsys alleges that Magma committed unfair business practices by asserting defenses of non-infringement and invalidity to patent infringement allegations brought by Synopsys in the patent infringement action already pending against Magma in the Northern District of California. On October 19, 2005, the Company removed the action to the United States District Court for the Northern District of California. On October 26, 2005, the Company moved to strike and dismiss the complaint. On October 27, 2005, the Court granted the Company's motion to relate the removed action with the preexisting patent infringement action, and both actions are now assigned to Judge Maxine M. Chesney.

On September 26, 2005, Synopsys, Inc. filed an action against the Company in Delaware federal court, *Synopsys, Inc. v. Magma Design Automation, Inc.*, Civil Action No. 05-701. The Complaint alleges infringement of U.S. Patent Nos. 6,434,733 ("the '733 Patent"), 6,766,501 ("the '501 Patent"), and 6,192,508 ("the '508 Patent") and seeks unspecified monetary damages, injunctive relief, trebling of damages, fees and costs, and the imposition of a constructive trust for the benefit of Synopsys over any profits, revenues or other benefits allegedly obtained by the Company as a result of its alleged infringement of the patents-in-suit.

On October 19, 2005, the Company filed its answer and counterclaims ("Answer") to Synopsys's Complaint. The Answer asserts that Magma's products do not infringe the patents-in-suit, that the patents-in-suit are unenforceable, and that the '733 Patent and the '501 Patent were fraudulently obtained by Synopsys and are

therefore unenforceable. The Answer also asserts antitrust counterclaims based on Synopsys's assertion of the '733 and '501 Patents, as well as claims for product disparagement and trade libel, statutory and common law unfair competition, and tortuous interference with business relations. The counterclaims seek treble damages and other equitable relief for Synopsys's anticompetitive and tortuous conduct.

On October 25, 2005, the Company filed an Amended Answer, adding a counterclaim for infringement of U.S. Patent No. 6,505,328 ("the '328 Patent"). The Company seeks treble damages and an injunction against Synopsys for the sale and manufacture of products the Company alleges infringe the '328 Patent.

In addition to the above, from time to time, the Company is involved in disputes that arise in the ordinary course of business. The number and significance of these disputes is increasing as the Company's business expands and it grows larger. Any claims against the Company, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in the diversion of significant operational resources. As a result, these disputes could harm the Company's business, financial condition, results of operations or cash flows.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

At Magma's annual meeting of stockholders, held on August 30, 2005, the following matters were considered and voted upon:

Proposal 1. To elect two Class I directors, to hold office until the 2008 annual meeting of stockholders. The votes cast and withheld for such nominees were as follows:

Nominee	For	Withheld
Roy E. Jewell	28,934,626	316,555
Thomas M. Rohrs	27,925,424	1,325,757

Proposal 2. To ratify the appointment of PricewaterhouseCoopers LLP as Magma's independent registered public accounting firm for the fiscal year ending April 2, 2006.

For	Against	Abstain
29,010,283	30,601	210,297

ITEM 6. EXHIBITS

The following documents are filed as Exhibits to this report:

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
4.1	Amended and Restated Certificate of Incorporation	10-K	000-33213	3.1	June 28, 2002	
4.2	Certificate of Correction to the Amended and Restated Certificate of Incorporation	10-K	000-33213	3.2	June 28, 2002	
4.3	Amended and Restated Bylaws	10-K	000-33213	3.3	June 28, 2002	
4.4	Amended and Restated Investors' Rights Agreement dated July 31, 2001, by and among the Registrant and the parties that are signatories thereto	10-K	000-33213	4.2	June 28, 2002	
4.5	Form of Common Stock Certificate	S-1/A	333-60838	4.1	November 15, 2001	
10.1	Form of Notice of Grant of Stock Options and Stock Option Agreement pursuant to Magma's 2001 Stock Incentive Plan for U.S. Employees (other than Executive Officers)					X
10.2	Form Notice of Grant of Stock Options pursuant to Magma's 2001 Stock Incentive Plan for Executive Officers					X
10.3	Form of Notice of Grant of Stock Options and Stock Option Agreement pursuant to Magma's 2001 Stock Incentive Plan for Employees residing in countries other than the United States, China, Israel, Italy and the United Kingdom					X
10.4	Form of Notice of Grant of Stock Options and Stock Option Agreement pursuant to Magma's 2001 Stock Incentive Plan for Employees residing in China, Israel, and Italy					X
10.5	Notice of Grant of Stock Options and Stock Option Agreement pursuant to Magma's 2001 Stock Incentive Plan for Employees residing in the United Kingdom					X
10.6	Notice of Restricted Share Award and Restricted Share Agreement pursuant to Magma's 2001 Stock Incentive Plan for non-Executive Employees					X
10.7	Notice of Restricted Share Award and Restricted Share Agreement pursuant to Magma's 2001 Stock Incentive Plan for Executive Officers					X
10.8	2005 Key Contributor Long-Term Incentive Plan					X

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer					X
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer					X
32.1	Section 1350 Certification of Principal Executive Officer					X
32.2	Section 1350 Certification of Principal Financial Officer					X

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MAGMA DESIGN AUTOMATION, INC.

Dated: November 14, 2005

By /s/ GREGORY C. WALKER

Gregory C. Walker
Senior Vice President—Finance and Chief Financial Officer
(Principal Financial and Accounting Officer and Duly Authorized Signatory)

EXHIBIT INDEX

TO

MAGMA DESIGN AUTOMATION, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED OCTOBER 2, 2005

		Incorporated by Reference				
Exhibit Number	**Exhibit Description**	**Form**	**File No.**	**Exhibit**	**Filing Date**	**Filed Herewith**
4.1	Amended and Restated Certificate of Incorporation	10-K	000-33213	3.1	June 28, 2002	
4.2	Certificate of Correction to the Amended and Restated Certificate of Incorporation	10-K	000-33213	3.2	June 28, 2002	
4.3	Amended and Restated Bylaws	10-K	000-33213	3.3	June 28, 2002	
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Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
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